

1 qualifications. I don't understand after a
2 telco made that investment, made those
3 commitments to that community, provided those
4 services, if they're getting \$10 or \$20 of USF
5 a month for that line, why should that bag
6 phone that has been in that car for ten
7 years -- as far as I know, any towers had been
8 built in that time -- should also receive the
9 same \$10 or \$20 a month?

10 COMMISSIONER ABERNATHY: I think I'm
11 going to stop now, because I do want to give
12 my colleagues time to ask questions. Thank
13 you.

14 COMMISSIONER NELSON: I do want to
15 welcome a former member of the Michigan
16 Commission staff, Ms. Parrish, who used to
17 work for us and did a great job many years
18 ago.

19 I want to focus on rule 305, which is
20 one of the issues that was teed up in this
21 proceeding. And I know, Mr. Cole, you
22 indicated you'd like to see the Commission
23 amend that rule. But would you agree with
24 Dr. Selwyn that the need for that rule goes
25 away if we redefine rural to look at the

1 geography as opposed to the individual
2 characteristics of the carrier? And wouldn't
3 that also mean that perhaps we wouldn't be
4 getting premiums paid in the amounts they're
5 being now for new territories because the
6 acquiring carrier would be getting the same
7 level of support as the carrier that gave up
8 the territory?

9 MR. COLE: As far as Dr. Selwyn's
10 proposal, I'm not sure I understand the
11 complexities of it. But I will answer as far
12 as to the premiums. I think at the same time
13 there has been a not a lot of transactions in
14 the last couple, three years. And I think
15 that's a part of it. Again, are those
16 premiums still applicable for those parties
17 based upon current regulatory and cost
18 environment within rural telcos?

19 Again, I think the purpose of the
20 safety valve was to take a look at those
21 markets that were acquired and say, are they
22 the same level of service that we would like
23 to see those markets? Have they have received
24 the same attention that the urban areas have
25 received? And if not, is there any incentive

1 or anything we can do where those customers
2 can get those same levels of service?

3 And I think that was the intent. I
4 think it's important to note that. I believe
5 as of this date, there has never been a dollar
6 disbursed under the safety valve program
7 because of this limitation. So, I think all
8 we're saying is that is the intent. And I
9 know in the properties we acquired we made
10 significant investments to upgrade not only
11 the loop and the plant, but also switching
12 facilities. And I believe our customers saw
13 definite improvements. And a lot of our
14 investments were made in that first year
15 because we felt it was so critical. And we
16 made commitments to local mayors, and we made
17 commitments to state regulators that we would
18 improve that service. And we did it
19 regardless of the fact that by spending those
20 dollar in the first year we were, in fact,
21 penalized because that set our base going
22 forward and precluded us from receiving the
23 same level of USF support.

24 COMMISSIONER NELSON: Dr. Selwyn?

25 DR. SELWYN: I want to make one brief

1 observation. The reference was made to
2 switching. I find it really very interesting
3 that the rural carriers feel an entitlement to
4 support for switching. In the TRO the
5 Commission concluded that CLECs, many of which
6 are smaller and more geographically disbursed
7 than some of the larger small rural carriers,
8 are not impaired with respect to switching.
9 CLECs are expected to go out and use risk
10 capital and purchase switching equipment and
11 are not going to have access to switching UNEs
12 at forward-looking TELRIC prices because of
13 the nonimpairment finding.

14 There are relatively few serious
15 scale economies associated with switching that
16 would be that particularly impacted by rural
17 areas. CLECs have been confronting the
18 problem having to connect exchanges located
19 over communities -- located over very broad
20 distances to a relatively small number of
21 switches. And the Commission has found that
22 that's an acceptable business model. And I am
23 concerned about the notion that the ILEC, the
24 rural ILECs feel that they have some specific
25 separate entitlement with respect to switching

1 costs that are being denied, in effect, to
2 other providers.

3 MR. COLE: Just to clarify, I don't
4 believe I made any statement that those
5 switching costs should have been included in
6 anything. I was only making that statement
7 about us replacing switches because we had one
8 state, the State of Wisconsin, as part of our
9 acquisition. The Commission made it a
10 requirement that we replace or that we
11 provide -- there were a number of them that
12 were there, and we were specifically required
13 to replace those switches as part of the
14 acquisition.

15 DR. SELWYN: But had rule 305 been
16 amended as you were proposing, then the cost
17 base would have been lower, and you would have
18 potentially been able to receive some
19 high-cost support based on that switching
20 investment, if I understand correctly what the
21 proposal is.

22 MR. COLE: I don't know that I'm
23 qualified to address that one.

24 COMMISSIONER NELSON: Dr. Lehman.

25 DR. LEHMAN: Your question about the

1 acquisitions disappearing, if it were done by
2 geography, there's one real concern
3 about that. And that's that we should expect
4 the fund to increase about tenfold. I mean,
5 if you look at the California results where
6 they do have the fund at the state level and
7 the size of that fund, we have the RBOC
8 territories that have a lot of high-cost
9 territories in them that would then become
10 eligible for high-cost funding.

11 And the problem that poses then is we
12 can't tolerate a tenfold increase in the fund.
13 So, what we'll do is we will then have to use
14 a forward-looking model of some sort because
15 that's the only model we can manipulate to get
16 a level of costs low enough to sustain the
17 existing size of the fund but extend it to all
18 geographic areas.

19 There is some appeal to me, the idea
20 that non-rural and rural carriers should be
21 treated the same. If a customer lives in a
22 high-cost area, who cares who their provider
23 is? Except we can't ignore history. There
24 has been a historical compact, if you like,
25 struck where non-rural carriers have agreed to

1 serve high-cost areas. And they have not
2 asked for a re-doing of the funds so that they
3 get the same treatment as rural carriers. So,
4 they're still willing to do that. And I think
5 really the best we can practically achieve is
6 to try to facilitate the transfer of exchanges
7 from those carriers that now consider it sort
8 of a burden to carry this along to carriers
9 that are willing to invest in those exchanges
10 and make the service better. And it doesn't
11 require the fund going up by a factor of ten;
12 it doesn't require some arbitrary reduction in
13 costs that can't be actually achieved by rural
14 carriers.

15 COMMISSIONER NELSON: You would
16 agree, though, that these carriers, you know,
17 to be a burden for them, probably have a lower
18 level of service than other rural carriers?

19 DR. LEHMAN: I think in many cases
20 they do, yes.

21 COMMISSIONER DUNLEAVY: Dr. Selwyn.

22 DR. SELWYN: I'm not sure that
23 characterizing the large RBOCs, for example,
24 in terms of their high cost of exchanges is
25 necessarily being a burden and that was the

1 basis upon which they chose to divest them.
2 They chose to divest those exchanges because
3 they were able to do so and capture a premium
4 value. The exchanges were worth more to the
5 buyer than to the seller, which is typically
6 why an economic exchange takes place. And
7 until the funding mechanism was modified to
8 provide those incentives -- until the
9 regulatory structure was modified to allow
10 carriers to earn revenues that -- and carry
11 them below the lines so they don't get
12 included in any reckoning of revenue
13 requirement, those perverse incentives didn't
14 exist.

15 We didn't see the Bell companies
16 selling off high-cost exchanges until very
17 recently. We didn't see it for the first,
18 almost, 100 years. They were net acquirers,
19 not divestors. And I'm not sure they ever
20 considered the burden. It's just that the
21 structure was changing and it became
22 profitable to sell them.

23 MS. PARRISH: To speak to Wyoming's
24 experience about sold exchanges is that Quest --
25 U.S. West sold 20-something exchanges ten

1 years ago. They were not very high quality.
2 They've become very high quality. But I think
3 that there can be abuse in the system as well.
4 So, that's the torn judgment that, has it
5 hurt. Because we have at least one company
6 that has essentially gold-plated that system
7 since acquiring it. But the other 20
8 exchanges have just become nice, wonderful
9 rural exchanges. So that's the problem is to
10 avoid the gold-plating or the abuse.

11 COMMISSIONER NELSON: I have one more
12 question for Dr. Lehman, and I promised I'd
13 come back to this in the previous panel. This
14 idea of indexing and if we agree that perhaps
15 we have different levels of calculations of
16 support for a rural carrier and a wireless
17 ETC, could we not index both of those and
18 perhaps move towards more harmonization of the
19 two methodologies over time?

20 DR. LEHMAN: Yeah. The idea of
21 indexing would have the same appealing
22 characteristics for both sets of ETCs. The
23 thing I would want to avoid is the equal level
24 of support, because who knows if it's equal.
25 In fact, I am willing to think that some

1 wireless carriers might deserve more support
2 than the current rural ILEC is getting, if
3 they could justify what the investments are
4 going to actually do and if some appropriate
5 regulatory Commission looks at it and says,
6 this is really something that's needed that's
7 going to be provided. So, I don't think the
8 levels of support should be the same, but
9 capping them does provide incentives for cost
10 reduction for both kinds of carriers.

11 COMMISSIONER NELSON: Thank you,
12 Madam Chair.

13 CONSUMER ADVOCATE GREGG: Dr. Lehman,
14 following up on that. If you believe that it
15 is not proper to equalize support and that
16 wireless and wireline technologies are
17 different, do you think that the current
18 support system for non-rurals, which provides
19 equal per-line support to all ETCs is wrong?

20 DR. LEHMAN: Yeah. I think it's just
21 as wrong as it is for the rural carriers, but
22 it probably matters less since it's so much
23 less support being collected by non-rural
24 carriers. It's very concentrated where it is,
25 and that's where you see competitive ETCs

1 apply for that status.

2 And the concern that I would have is
3 what demonstration do we have that the higher
4 support -- that high-costs are what those
5 wireless carriers are actually experiencing
6 there, and that they're using the money to
7 actually upgrade service there. So, that's
8 all I would ask for is that they demonstrate
9 their need for the support and their use for
10 the support, whether it's a rural or non-rural
11 territory.

12 CONSUMER ADVOCATE GREGG: Mr. Bergs,
13 you stated that there was a natural cap on the
14 amount of support that would be paid to
15 support multiple lines in high-cost areas.
16 Given that the projections for incumbent rural
17 LECs for the first quarter 2005 on an
18 annualized basis is for support of two and a
19 half billion dollars, what level of cap would
20 you think that we would ultimately reach if we
21 allowed the fund to just continue to rise to
22 its natural level?

23 MR. BERGS: Well, first of all, I
24 want to clarify. The amount of support
25 provided to a competitive ETC is what I think

1 has a natural cap attached to it because,
2 again, as each competitor enters a market, a
3 consumer is only going to purchase one or
4 maybe two lines. And, in fact, I believe that
5 in the long run while it's been demonstrated,
6 I think there's some agreement amongst the
7 panel that wireless isn't currently accepted
8 as a substitute for wireline. That number has
9 increased over the last couple of years from
10 an estimated 3 percent up to, now, an
11 estimated 6 or 7 percent.

12 And over time -- well, first of all,
13 the reason for that, I think, is wireless
14 hasn't received funding in the past, and as a
15 result hasn't been able to build the
16 infrastructure required to avoid the
17 antiquated equivalents of a party line only in
18 wireless terms. So, I think in the long run
19 you're going to have some more substitution
20 and, in fact, you're going to see a downward
21 turn in the overall amount of support.

22 I can't give you a number for where
23 this is going to top out, but one way to
24 control that is to maintain a cap or at
25 least -- until we can come to a true

1 portability of support from wireline to
2 wireless, we maintain a cap on the wireline
3 cost portion of the funds and allow CETCs to
4 enter. As competition comes in, again, we can
5 pick our number and we can create our
6 multiplier, X dollars of per line support
7 times two connections for every person living
8 in that high-cost area.

9 And, again, one of the keys to
10 reducing the impact of the current mechanism's
11 ability to grow in the short term is to
12 disaggregate that support. If we put it only
13 in the high-cost areas, the only way that
14 growth increases astronomically is if more
15 people move into that highest cost area of a
16 study area, breaking it into the zones has
17 that inherent cap effect.

18 MR. COLE: I would comment on the
19 concept of a natural cap if you have multiple
20 wireless carriers within that. I guess I
21 would disagree and maybe reference to some of
22 the testimony that was in the pre-filed
23 document that I had, where there had been
24 situations of where there are more wireless
25 subscribers on a billing list than there are

1 population in the area. I mean, that's one
2 wireless carrier. If you add multiple, that
3 can happen.

4 I know this is similar to the article
5 we talked about earlier. You're always going
6 to have anomalies. You're going to have
7 things that aren't done appropriately and
8 don't make that rule instead of the exception.
9 But I would point you to those references to
10 say that under the current system that
11 incentive exists.

12 In the past ten years -- or until
13 about five years ago, I was in the wireless
14 area of our business and was the president of
15 our wireless operation for a couple of years.
16 And I can tell you it was a constant
17 challenge. When you have compensation
18 programs, at that point for distribution,
19 whether it be agents or others, that promote
20 uneconomic things to happen, they're going to
21 happen. The things you incent are going to
22 happen. And if you incent funds based on
23 customers on a billing list, that billing list
24 is going to be higher probably than it should
25 be, whether that's going to a bank in a

1 metropolitan area that has 50 branches and 1
2 branch in the rural area. And the salesman
3 says, hey, if you'll let me send all the bills
4 to that branch, I'll give you a 10 percent
5 discount. I'm not saying those things are
6 happening but the incentive is there, and that
7 is some of the risk you run with the current
8 system that we have in place.

9 COMMISSIONER JABER: I thought it
10 would be appropriate to end the questioning by
11 delving into the logistical aspects of
12 whatever gets implemented, and Mr. Johnson
13 touched on that a little bit with regard to
14 workshops. But the general question for any
15 of you is that in determining what the
16 appropriate methodology will be going forward
17 and calculating support, what is the best
18 procedural mechanism the FCC should use to
19 adequately determine the best approach? And
20 I'd ask, and you have already, to think
21 outside the box of the traditional paper
22 hearing that the FCC and the Joint Board uses.
23 That's the first general question -- and not
24 that there's anything wrong with that.

25 The second question relates to the

1 logistics associated with administrative
2 expenses and what ongoing role USAC would
3 have, and is there a mechanism that mitigates
4 the concern as it relates to cost studies that
5 get presented and USAC implementation going
6 forward. Those are the two questions.

7 MS. PARRISH: Commissioner, as to
8 your first question, in addition to any
9 process that is used to come up with --
10 whether it's a form for the wireless
11 submitting their embedded costs or a model for
12 forward-looking costs, I think there should be
13 some procedure prior to implementation but
14 after development for parties to comment.
15 It's that I think that when the non-rural model
16 was developed there were a number of parties
17 that late in the game said, wait, some of the
18 inputs are wrong. But it was too late,
19 really, to change it before it needed to be
20 implemented. So, I think there needs to be to
21 general-to-the-world opportunity to look at
22 what has been developed and say, you know,
23 here are the key inputs; you know, do these
24 look right for your company or for your state.
25 And so, I would offer that suggestion.

1 COMMISSIONER JABER: Anything
2 relating to the USAC concern?

3 MS. PARRISH: My suggestion for USAC
4 may be a little off point of this hearing, but
5 one of the concerns I have has to do with the
6 certification of the funds. I think that some
7 of the -- I think I can speak for my own
8 state, is that on the wireless certification
9 it was simply a self-certification done by the
10 carrier to the Commission, forwarded to the
11 FCC. And there were some strong concerns
12 about that self-certification. And I don't
13 believe USAC is doing any auditing of those
14 certifications at this point, and I understand
15 resources issues and so forth. But, you know,
16 in my ideal world, I think that the auditing
17 or spot-checking of certifications would be a
18 very useful thing.

19 MR. JOHNSON: I was to going comment
20 on that second question as well. We've been
21 told that USAC has been directed to conduct a
22 number of audits of receivers of high-cost
23 funds over the 2005 calendar year. And I
24 understand they're gearing up to do that. And
25 it struck me that if CETCs should -- you know,

1 we develop a mechanism for CETCs to report
2 their own costs and receive funds based on
3 that, they ought to have a similar audit
4 process. There's not going to be much
5 difference in the process itself, you're
6 obviously auditing different numbers. But
7 you're not auditing a different process.

8 COMMISSIONER JABER: Dr. Selwyn.

9 DR. SELWYN: As to your first
10 question, it seems to me that any carrier,
11 whether it's an ILEC or a CETC, that is going
12 to be relying on its own costs as a basis for
13 support, should be required to provide
14 information with respect to that if we're
15 going to adopt any sort of embedded cost
16 standard. And it's been suggested that CETCs
17 should also provide embedded costs. I don't
18 think that -- for reasons I've talked about
19 that having a different level of funding for
20 CETCs versus ILECs is appropriate.

21 In any event, if the ILEC funding
22 mechanism is to be maintained, the support
23 needs to be examined with respect to all
24 revenue sources associated with that
25 infrastructure, not just sources of revenue

1 that are considered to be associated with
2 local service. If the ILEC is capable of
3 operating profitably with all it's revenue
4 sources, it shouldn't be entitled to -- and
5 support in whatever it does draw should be
6 based upon the deficiency relative to all
7 revenue sources.

8 I believe that going forward we
9 should be looking at forward-looking costs
10 that are not based on specific carrier costs,
11 but are based upon model costs which reflect
12 what would be expected from an efficient
13 provider. And that should be the basis for
14 funding all carriers. And that, in effect,
15 gets us out of the rate case and auditing
16 requirements. If a carrier wants and believes
17 that it -- it confronts such extraordinary
18 conditions that the model costs simply do not
19 capture those conditions and it wants to make
20 a case, then it should, in effect, make a
21 revenue requirement case.

22 MR. JOHNSON: Can I make the comment,
23 please, related to that? I heard in the
24 earlier panel something that I thought was
25 just blatantly wrong. And that is that rural

1 LECs are not -- no one is looking at their
2 costs and therefore no one is -- they're just
3 free to run wild.

4 I said the last time I appeared
5 before you that we have lots of reasons to be
6 efficient, not the least of which is we have
7 competition in many of our operating areas.
8 But at least one commissioner before me right
9 now is a commissioner in a state in which we
10 do business in which they do rate reviews
11 quite often and look very hard at our cost
12 studies and our separations and what we're
13 actually doing and asks very, very difficult
14 questions. So, this idea that somehow we're
15 not being regulated as to rates and just
16 allowed to run wild and rampant is just
17 absolutely and patently false and absurd.

18 MR. BERGS: I'd just comment on the
19 second question that you asked. If we move to
20 a system where CETCs' support is based upon
21 their own costs, not only are we taking
22 away -- are we in fact motivating that CETC
23 the same way we have historically motivated the
24 ILEC to increase its cost in order to get more
25 support, hopefully the net result being more

1 infrastructure is developed, but even in an
2 inefficient manner.

3 But beyond that, logistically, you
4 are forcing an absolute duplication of an
5 effort that we admittedly -- or I believe USAC
6 admitted has not been historically been able
7 to maintain. One of the comments I noted in
8 the USA article that was referenced earlier is
9 that USAC staff is simply unable from a
10 manpower standpoint to do the kinds of audits
11 that they would need to do. Now, what we
12 would be asking them to do is double first,
13 upfront the cost studies that they have to
14 initially identify to create the basis for
15 support and double an unattained level of
16 audit to ensure that those funds are actually
17 being spent appropriately.

18 MR. COLE: One thing I might -- just
19 to your question, because I do -- it's a tough
20 question to answer because I think it does
21 entail a lot. I would say, though, that from
22 my prior experience -- I did serve, I think,
23 at one time on the finance committee at the
24 CTIA when I was in the wireless business. And
25 I know we endeavored at that time to try to

1 come up with some standard accounting, some
2 standard ways of recognizing the commissions
3 and other things. Well, being involved in our
4 partnerships and also in others, I think there
5 is some pretty standard accounting methodology
6 that would not make that an impossible task.

7 Also in a number of the rural service
8 areas because of the way the incentives began
9 are represented by separate rural service
10 areas. Independent telcos and others have a
11 separate set of accounting records, even for
12 their specific area, not necessarily that
13 service area, but at least more defined
14 geographically. So, I do think it's possible,
15 and I do think there is some consistency. And
16 I think the analysis of costs would be
17 possible. How to take that and equate that to
18 USF support would be very challenging. Thank
19 you.

20 COMMISSIONER ABERNATHY: Thank you
21 very much to the commissioners on the joint
22 board and also to the panelists. This was
23 very, very informative for us. No doubt we
24 will have many interesting debates as we go
25 forward dealing with all of this. But I do

1 appreciate all your time here, for your
2 written submissions, and for your willingness
3 to come there. So, with that, we are
4 adjourned.

5 (WHEREUPON, the second panel
6 concluded at 4:55 pm.)

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1 REPORTER'S CERTIFICATE

2

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6 I, MELISSA M. SCHEUERMANN,
7 Court Reporter, with offices in Nashville,
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10 UNIVERSAL SERVICE SUPPORT FOR AREAS SERVED BY
11 RURAL CARRIERS AND RELATED ISSUES by machine
12 shorthand to the best of my skills and
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15 I further certify that I am
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Associate Reporter
Notary Public
State of Tennessee At Large.

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PREPARED BY:**

**HERITAGE REPORTING CORPORATION
1220 L Street, N.W.
Suite 600
Washington, DC 20005
Phone: 202-628-4888
FAX: 202-371-0935**